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# Tax for Good: The impact of non-transparent outflows on Africa's economic development

Dr Sarah Tzinieris

Research Fellow, King's College London

Last month, major changes to Nigeria's taxation system came into [force](#). Dating back to 2012, the Income Tax (Transfer Pricing) [Regulations](#) are aimed at enhancing tax disclosures and tackling tax evasion and avoidance. The regulations are applicable to most taxable entities – also extending to Nigeria's lucrative extractives industry which accounts for more than half of government [revenues](#). The new tax regime in Nigeria reflects a global-wide clampdown on corporate strategies that seek to shift profits from higher-tax jurisdictions to lower-tax ones.

## *Africa's financial outflows worth more than inflows*

Nigeria's step paves the way for other sub-Saharan African governments to derive fairer financial rewards from their natural resources. Lack of transparency in the tax affairs of multinationals investing in Africa results in vast financial outflows from the continent, ultimately denting economic development in some of the world's poorest countries. The problem concerns aggressive financial planning on the part of corporations with the aim to maximise revenues. Tax-led strategies include tax avoidance schemes, undisclosed financial transfers and opaque transactions. Such practices are particularly prevalent within the mining and hydrocarbon sectors, on which a number of African economies are reliant for government revenues and inward investment.

According to the UN Economic Commission for Africa, illicit financial outflows from Africa are worth [double](#) what the continent receives in official foreign aid. Even when adding foreign direct investment (FDI) into the mix, illicit outflows are still worth [more](#) than FDI and aid combined. These outflows encompass a range of illegal and unethical activities such as corruption, smuggling, trafficking and organised crime, not only tax avoidance and evasion. Nonetheless, the reduction of the national tax base is a crucial issue to address because these types of financial flows can be legally retained by the host country.

## *Opaque tax planning in sub-Saharan Africa*

Contained in Nigeria's new tax regime are some of the highest penalties in the country's history of taxation. Companies and other taxable entities are therefore expected to comply with the revised regulations. Nigeria's decision to finally implement its tax reforms, first published six years ago, reflects the government's growing confidence to hold external investors to account. It is estimated that Nigeria [loses](#) up to US\$5 billion a year in revenue due to opaque tax planning in the country's offshore oil and gas sector. The boost to Nigerian public finances will be watched with interest by other governments on the continent.

Sub-Saharan Africa as a whole is estimated to [lose](#) an average of US\$41 billion a year as a result of aggressive tax planning. Multinational corporations and other entities

facilitate tax avoidance and evasion in a number of ways, including by shifting revenues to more favourable tax jurisdictions (transfer pricing) and by false invoicing (mispricing). Depending on the jurisdiction, not all of these tax schemes are illegal, nevertheless they tend to operate in the grey area of the law. It requires specialised tax inspectors and substantial funds to identify illegal tax schemes and enforce tax rules – resources that most African governments do not possess. Indeed, Nigeria's threat to impose high financial penalties for non-compliance represents a punitive tactic since it lacks the teeth to enforce full compliance through tax inspection. Even in the most developed economies, tax inspection of all revenues diverted to overseas holding entities, shell companies and subsidiaries is nigh on impossible.

### *Tax arrangements exacerbate the 'resource curse'*

African governments – not only foreign corporations – must also share the blame for the failure of resource revenues to contribute to socio-economic development. Fragile state institutions, endemic corruption and weak governance all serve to diminish and divert public finances. Many of the extractives-led economies in sub-Saharan Africa are associated with the 'resource curse', the correlation of abundant natural resources with low levels of socio-economic development – a situation particularly evident in Angola, DR Congo, Equatorial Guinea, Gabon Niger and Zambia. The colonial experience has also created structural weaknesses in governments' leverage over foreign investors, with long-standing tax arrangements being difficult to re-negotiate.

According to the Organisation for Economic Co-operation and Development (OECD), the [average](#) tax-to-GDP ratio in sub-Saharan Africa is only 19%, compared to 23% in Latin America and the Caribbean and 34% in OECD countries. Notwithstanding these alarming regional comparisons, development trajectories do vary widely across the continent and the resource curse is not inevitable. As attested by [Botswana](#), a public sector-led development model – combined with sound fiscal and monetary policies – can ensure that natural resources contribute to economic growth and stability. Efforts by the Extractive Industries Transparency Initiative (EITI) have also helped improve transparency in contracts and business activities across the continent.

### *A multilateral approach to tax?*

In the past three years, the international community has taken encouraging steps to ensure more transparency in global tax flows. The OECD's base erosion and profit sharing (BEPS) [project](#) has played an instrumental role in coordinating international activity, developing toolkits to assist 'lowest income countries'. The difficulty for African governments is that by implementing punitive measures against tax dodgers, they risk disinvestment – creating a race to the bottom by corporations looking to maximise revenues. A coordinated approach across the continent is therefore critical to achieve change. The potential benefits are worth it. Reclaiming lost tax revenues could bring millions out of poverty and place sub-Saharan Africa on a more equal footing with the countries to where financial outflows are currently being diverted.